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DYNEX

Petroleum Ltd.

1982 Annual Report

Corporate Profile

Dynex Petroleum Ltd., an Alberta corporation, was originated in 1974 to develop and produce shallow gas in the Medicine Hat field of southern Alberta. This area still provides the reserves and cash flow basis for the Company. A management team specializing in the production technology necessary to maximize the profitability of the shallow, tight gas zones was assembled. As interests expanded to include all of Alberta, B.C. and the western U.S., professionals with abilities in exploration and production in other types of prospects were added to the team.

During 1979, the Company established a wholly-owned U.S. subsidiary, Dynex Energy Inc. The following year this expansion into the U.S. culminated in the assembly of a Denver based exploration staff and several U.S. drilling ventures.

Dolphin Drilling, the Company's contract drilling division, operates four drilling rigs in Alberta.

On February 6, 1980, Dynex completed a public offering of its shares in Canada. This and a subsequent sale reduced the interest of its majority shareholder, Dunoco Corporation of Houston, from 100 percent to 66 percent. As of April 28, 1983, the 14,780,000 outstanding common shares of Dynex were held by 901 registered shareholders with a broad distribution across Canada. Dunoco Corporation, a U.S. public company, held 9,710,000 of those shares.

Quarterly Summary of Stock Prices and Volumes

TRADED ALL EXCHANGES

	High	Low	Shares Traded
June/82 - August/82	\$0.97	0.65	365,350
September/82 - December/82	\$1.40	0.75	493,050

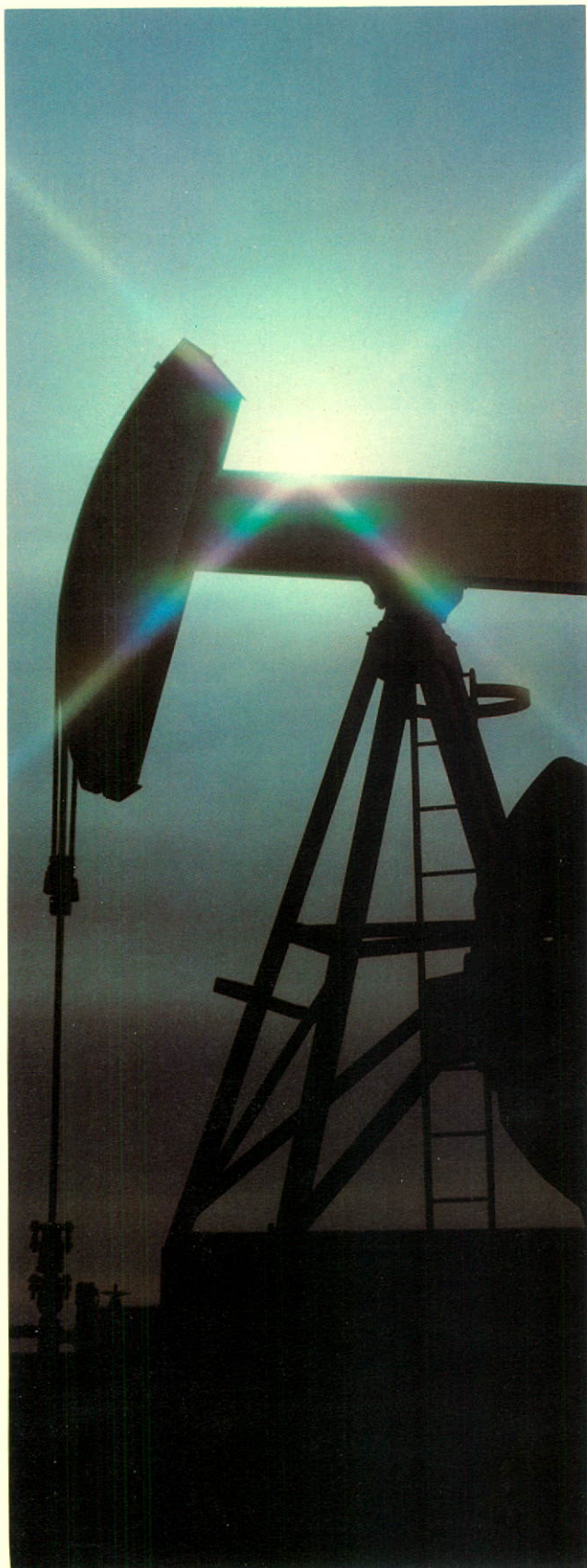


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Highlights

	Seven Months Ended December 31, 1982	Year Ended May 31, 1982
Financial and Operating Highlights (thousands of dollars except per share amounts)		
Financial		
Net loss	\$ 2,103	5,935
Per share	\$ 0.14	0.40
Cash flow (deficiency) from operations	\$ 162	(2,104)
Per share	\$ 0.01	(0.14)
Long-term debt	\$57,942	62,789
Shareholders' equity	\$ 3,710	5,813
Operating		
Gross crude oil and natural gas liquids production (bbls)		
Canada	56,933	63,237
United States	29,878	73,538
Per day	406	375
Gross natural gas production (mcf)		
Canada	2,713,264	6,877,519
United States	435,257	500,115
Per day	14,713	20,213
Marketing volumes (000's of gallons)	19,281	28,487
Per day	90	78
Drilling days	515	977
Average utilization	60.2%	66.9

Annual General Meeting

The Annual General Meeting of the Shareholders will be held at

International Hotel (Manhattan Room)
 220 - 4 Avenue S.W.
 Calgary, Alberta

on June 8, 1983 at 3:00 p.m. M.D.T.

Report to the Shareholders

On behalf of the Board of Directors, we wish to present the Company's annual report and audited financial statements to December 31, 1982. We are very pleased to announce that the last quarter of the seven month reporting period marked a turnaround in the Company's affairs and a return to positive cash flow. The Company has adopted a calendar year end, which will simplify comparisons with other companies; consequently, for this reporting period we are using the seven months from May 31 to December 31, 1982 as a fiscal year.

For this one time only, comparative results will be difficult to extract. In the following financial summary we have shown an annualized figure in brackets to indicate a comparative number to the previous reporting period of 12 months ending May 31, 1982 although seasonal variations do not permit this figure to be a strictly valid projection. Gross revenue for the seven month period totalled \$24,538,000 (\$42,065,000), up \$5,075,000 or 13.7 percent from \$36,440,000 in the previous period. A loss of \$2,103,000 (\$3,605,000) (14¢ per share) was experienced compared with a loss of \$5,935,000 (40¢ per share) for the previous period. Cash flow from operations showed a recovery to a surplus of \$162,000 (\$278,000) (1¢ per share) compared with a deficiency of \$2,104,000 (14¢ per share) for the fiscal year ending May 31, 1982. Capital expenditures, primarily for oil and gas ventures totalled \$2,248,000 (\$3,939,000) compared with \$13,052,000 in the previous period. Revenue from oil and gas production increased to \$7,669,000 (\$13,147,000) from \$12,735,000 during the previous period.

In Canada, exploration activities were undertaken on the Turin, Corbett Creek and Hotchkiss properties as well as development drilling in the Medicine Hat, Rattlesnake and Castor projects. In total, the Company participated in the drilling of 39 wells during the seven month period which resulted in eight oil wells, 29 gas wells and two dry holes, for an overall success ratio of 95 percent and a success ratio of 50 percent on its exploration wells.

In the United States, efforts were concentrated on step-out drilling in the East Texas area; the Pettet and Travis Peak zones in this area have yielded five additional oil wells and further work is planned to develop this area. Another program is planned to drill five evaluation wells on the Company's Galvan Ranch property during the summer of 1983 at no cost to Dynex.

We are pleased to report that Dolphin Drilling had another very successful year with much better than average results. We are looking forward to another active and profitable year.

During the reporting period, Dynex undertook to restructure its marketing operation with the intention of ultimately phasing out the division. Marketing will continue for three years as a joint venture operation with the former employees of the division acting as the Operator.

During the seven month period, Dynex emphasized the use of outside investors' funds for drilling. A highly successful fund was placed in Canada for Dynex by Gardiner Watson Limited and was, in fact, oversold at \$4,700,000. The fund provided maximum grant usage and tax shelter to the investors. We believe that the investors will have a very favorable return on their investment and we expect that many will be repeat investors. We look forward to these funds being a favored investment for tax shelter seekers provided a fair and reasonable return is given by the operator to the investor.

In the U.S.A. the Company raised a total of \$1,300,000 during the seven month period. This brings the total funds raised to date to \$7,300,000 since November, 1981. Subsequent to year end, a contract was executed which will, when completed, see Dynex carried through ten wells on the Galvan Ranch with the investors spending \$3,500,000 to evaluate the prospect for Dynex.

The warm weather this past winter combined with the recession resulted in very low nominations by the Company's principal gas purchaser, TransCanada

PipeLines. There has been a deterioration of domestic consumption as well as exports to the U.S.A. Prior to year end and into the current period, "takes" have been in the order of 40 percent to 50 percent and we project the average nomination to be 50 percent for the present contract year. Dynex has been able to partially offset these low deliveries with temporary contracts. We do expect that we will be receiving a further cash prepayment in lieu of gas "takes" from T.C.P.L. as they are required to "take-or-pay" for 60 percent of our contract volume under the modified contract signed during 1982.

We are very encouraged by statements made by the new federal Energy Minister which indicate a recognition of over-regulation and over-taxing of the industry and an indicated desire to reach a cooperative atmosphere with the Province of Alberta and the oil industry. Several developments such as the gas export price reduction indicate that the federal government has at last begun to consult with and respect the opinions of the industry before taking action.

Outlook

We anticipate that the natural gas demand will remain low until the fall of 1983 with increased sales during the next winter and a return to very healthy export volumes in November, 1984. The U.S. gas deliverability surplus will be eliminated due to natural decline of producing wells which were completed during 1982, and a resurgence in demand as the U.S. economy recovers from the current recession. These exports will result in higher deliveries and higher prices to Dynex.

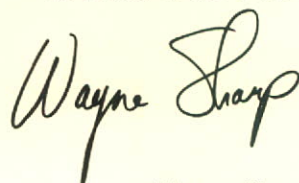
Another bright spot in our industry is that due to the slowdown in activity, the constant escalation in capital costs has stopped; in fact, costs have dropped substantially. The economics of drilling new wells are better than at any time in the past several years, since the cost of drilling has been reduced more than the projected reduction in energy prices.

We see a revived market for quality drilling funds in Canada as investor confidence and interest in tax shelter investments recovers. The oil and gas industry is one of the few remaining opportunities for sheltering income from other sources. We plan to offer a second fund during 1983 which will begin generating significant cash flow during 1984. Our initial fund will reach the reversion point in early 1984 and begin providing revenue to Dynex at that time.

We intend to pursue the acquisition of new interests by means of share exchanges in order to increase the Canadian ownership of the Company, but more importantly, to expand our equity base and increase our cash flow.

We have weathered a financially trying period and are now looking ahead to better times. The Company's high quality long life reserves continue to supply the underlying value and revenue base for our continued growth. Our enthusiastic and loyal employees have helped make it possible for us to have a positive outlook to the future of Dynex. It is appropriate that we start a new year end at the same time as we embark on a program of consolidation and growth.

On behalf of the Board



Wayne Sharp
President



Exploration and Development

During the seven months ending December 31, 1982 Dynex participated in the drilling of 39 gross wells (11.9 net), of which 34 wells were drilled in Alberta and 5 successful wells were drilled in Texas.

This marked increase in Canadian activity over the previous twelve months resulted from the use of drilling funds and the Alberta Government incentive program. U.S. activity was significantly reduced with the only activity being in East Texas.

The Company's activity was primarily development drilling which added proven reserves to the existing long-term reserves that provide the basic strength of Dynex.

DRILLING ACTIVITY

	GROSS		NET	
	Exploration	Development	Exploration	Development
Oil	2	6	0.43	1.15
Gas . . .	—	29	—	9.43
Dry . . .	2	—	0.84	—
Total ..	4	35	1.27	10.58

WESTERN CANADA

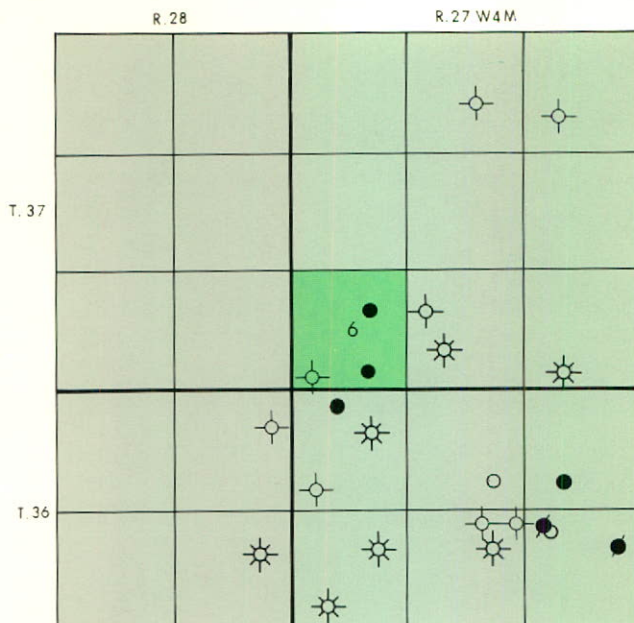
Thirty-two successful wells were drilled in Southern Alberta; three oil wells and 29 gas wells.



SOUTHERN ALBERTA — OIL

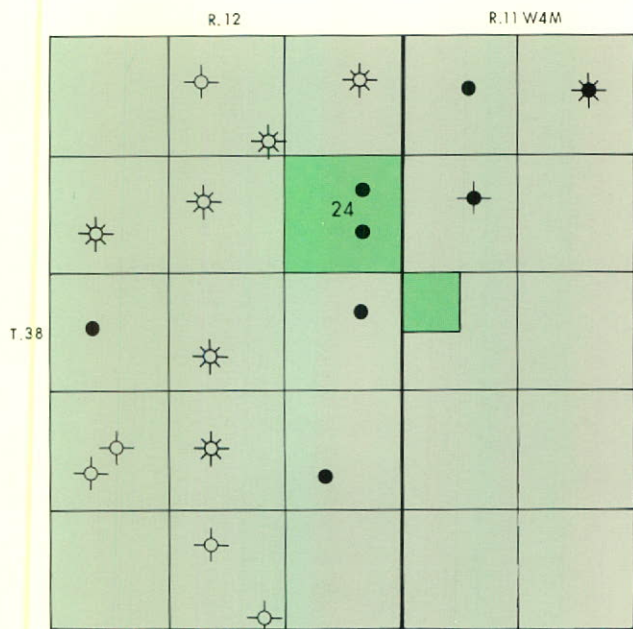
Penhold

Dynex holds a 7.4 percent working interest (until "payout") in a well drilled in Lsd. 10-6-37-12-W4M. This well has been classified as a New Oil Reference Price (N.O.R.P.) oil well and is a direct offset to the original oil well located in Lsd. 2-6-37-12-W4M. The 10-6 well has also encountered a significant shallow gas zone which may be further developed at a later date.



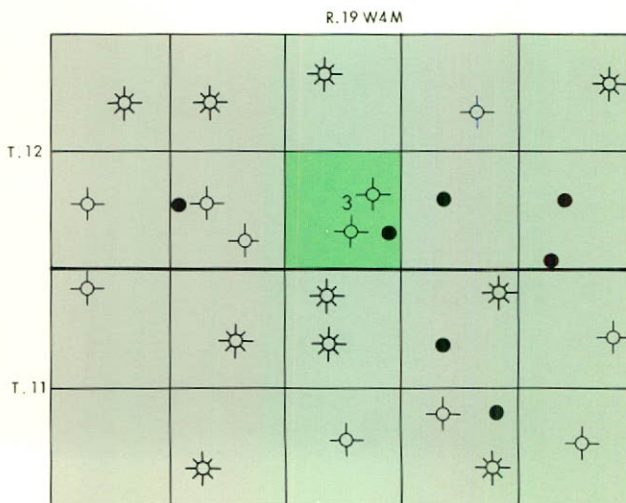
Castor

An offset development well, located in Lsd. 7-24-38-12-W4M, was successfully completed as a Viking oil well and has current production rates of 25 BOPD. Dynex holds a 19.8 percent working interest in the Castor properties and has recently acquired additional acreage in the Castor area for proposed drilling in 1983 which should qualify for N.O.R.P. The Company is actively pursuing further extensions of this play and other plays in the area.



Turin

A successful N.O.R.P. oil well was drilled after the year end on the Turin properties. Dynex currently has a 24.2 percent working interest in the lands, however, after payout Dynex's interest will increase to 59.4 percent. The 8-3-12-19-W4M well also produces economic quantities of natural gas and facilities are being installed to market the natural gas in addition to the oil. Further drilling will be evaluated after a long-term production test on the existing well.

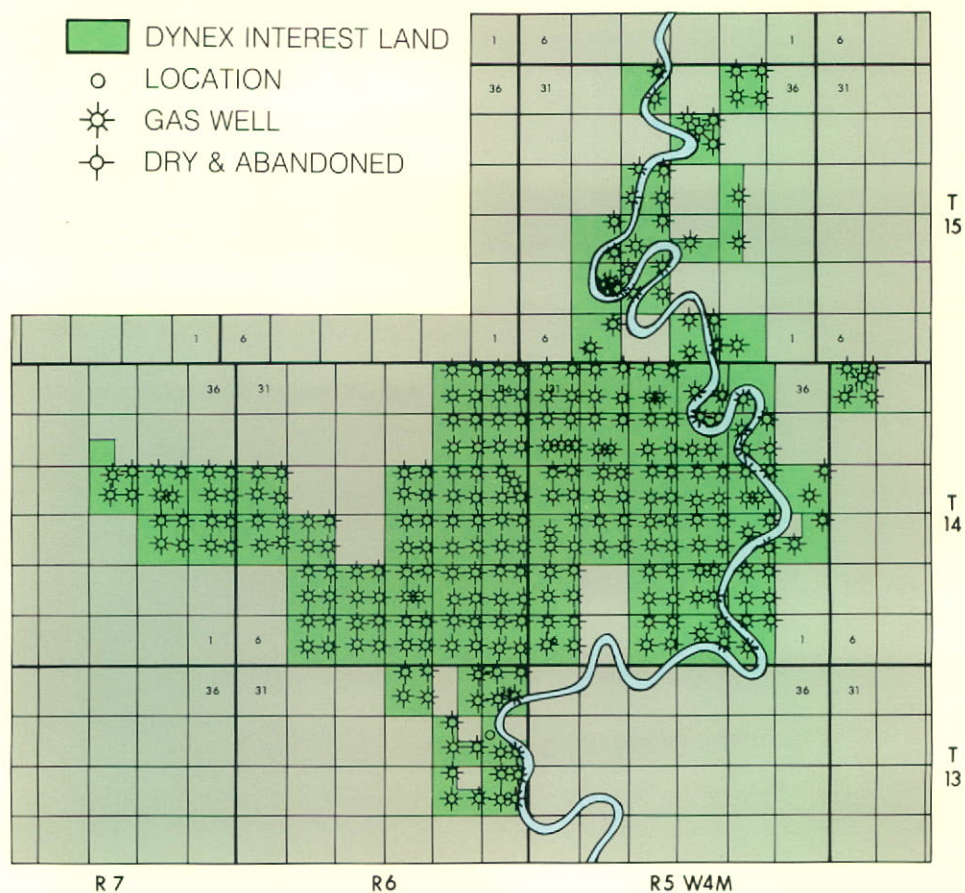


SOUTHEASTERN ALBERTA — GAS

Medicine Hat Area

The Alberta Government incentive program provided approximately 30 percent of the drilling costs for six gas wells in which Dynex has 40 - 100 percent working interest. Three of the wells have been completed and connected to Dynex's Drowning Ford processing facilities with the remaining three to be completed in

mid-1983. The Medicine Hat properties are almost fully developed with only 16 infill locations remaining. Due to the large cutbacks by the purchaser, these infill wells will be deferred until 1984 or later. Reservoir performance continues to indicate that this area will be a long-term source of revenue to Dynex.



Rattlesnake

During the seven month fiscal year, production averaged 1.72 MMCF/D, virtually static compared to the previous year. The initial pumpjack program for removal of water from the wellbores was evaluated. As a result of the evaluation, additional pumping facilities were installed in November resulting in a 17 percent increase in production in December. The production rate is expected to double that of 1982. The success of the pumpjack program and the infill drilling program resulted in the recoverable gross reserves increasing 3.6 times to 17.3 BCF. Dynex is formulating plans for additional development drilling for mid-1983.

Drilling Fund

Through the joint efforts of Dynex Petroleum Ltd., Blackrock Resources Ltd. and Gardiner Watson Ltd., approximately \$4,700,000 was raised from the investment sector of Canada for the establishment of a drilling fund. These funds were used for exploration and development of oil and gas properties in Canada.

After the establishment of the fund, Dynex entered into an agreement with Blackrock, the general partner, to form a limited partnership and initiate a drilling fund known as Blackrock Exploration Program No. 1. Under the terms of the agreement, Dynex operated, on behalf of Blackrock, a drilling program to drill 25 new wells and recomplete one additional well.

In the Rattlesnake area, Dynex and Partners "farmed out" 22 well spacing units (each unit contains 320 acres) to Blackrock and in turn, Blackrock drilled one

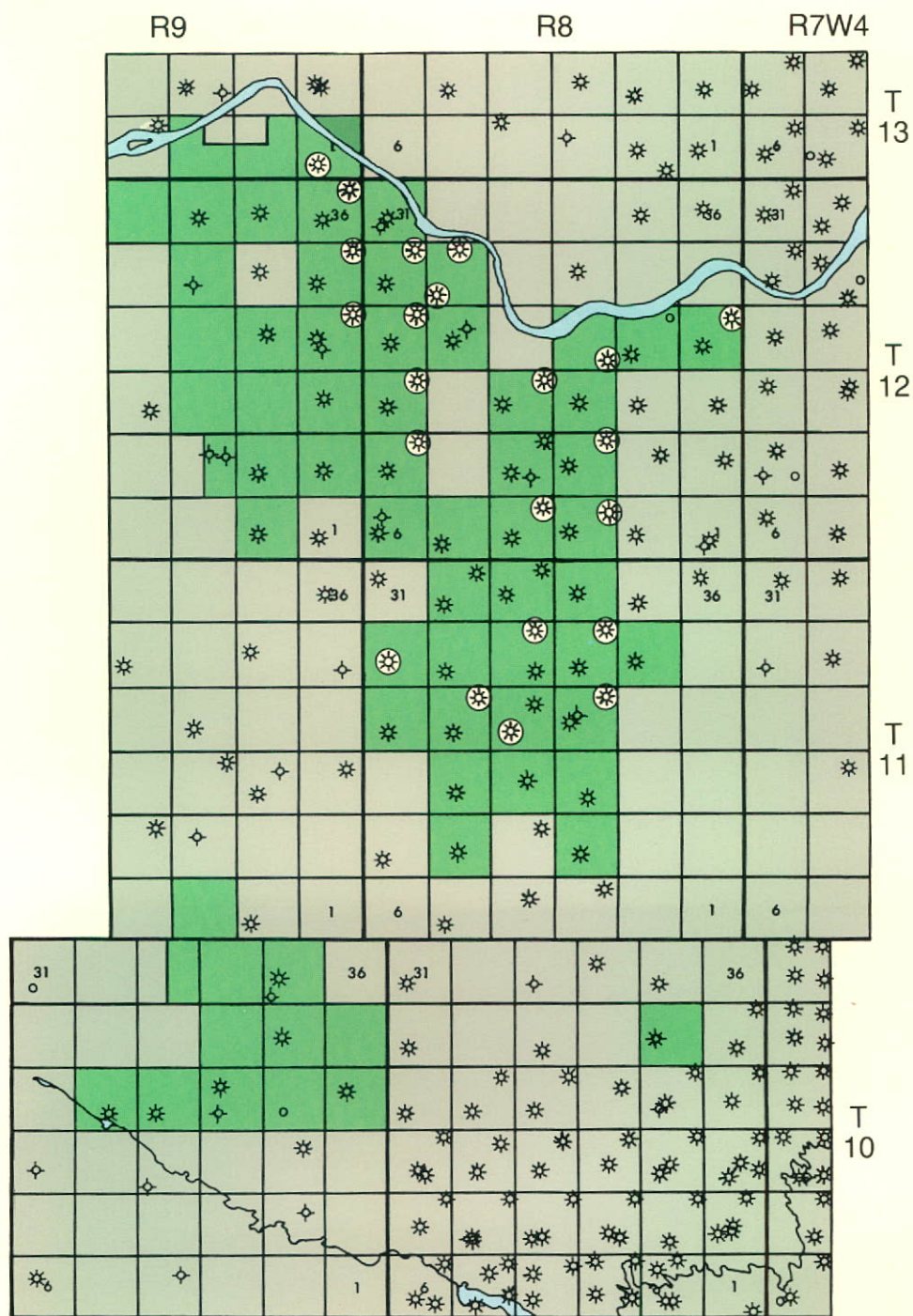
well per spacing unit to evaluate the Second White Specks zone, as well as complete and tie-in the economically successful wells. Blackrock has the opportunity to recover its net cost for the wells drilled from production revenue. Upon such recovery Dynex "backs-in" for a 23.75 percent working interest in the well spacing units. This "back-in" will occur in early 1985.

Blackrock contributed 100 percent of the cost to drill an oil well in Turin. After Blackrock recovers its investment cost, Dynex will "back-in" for a 50.0 percent working interest in these lands.

Blackrock participated in three other wells which were not as successful as the Rattlesnake and Turin wells. The first well was the recompletion of the Sylvan Lake well which had encouraging oil production initially but has declined to the extent that the well may have to be abandoned in 1983. The second well was drilled on the Hotchkiss acreage. After drilling to the targeted Debolt formation, testing indicated that the reservoir contained uneconomical heavy oil. Subsequently, the well was abandoned. The third well drilled was a Mississippian test on the Corbett Creek lands which resulted in the prospective zone being wet therefore, this well was also abandoned.

The overall results of the drilling fund program has resulted in 22 gas wells, one oil well, one suspended oil well and two abandoned wells. In combination with the Development Drilling Incentive Supplement initiated by the Alberta Government in mid-1982, the Blackrock Exploration Program #1 was a success for both Blackrock and Dynex.

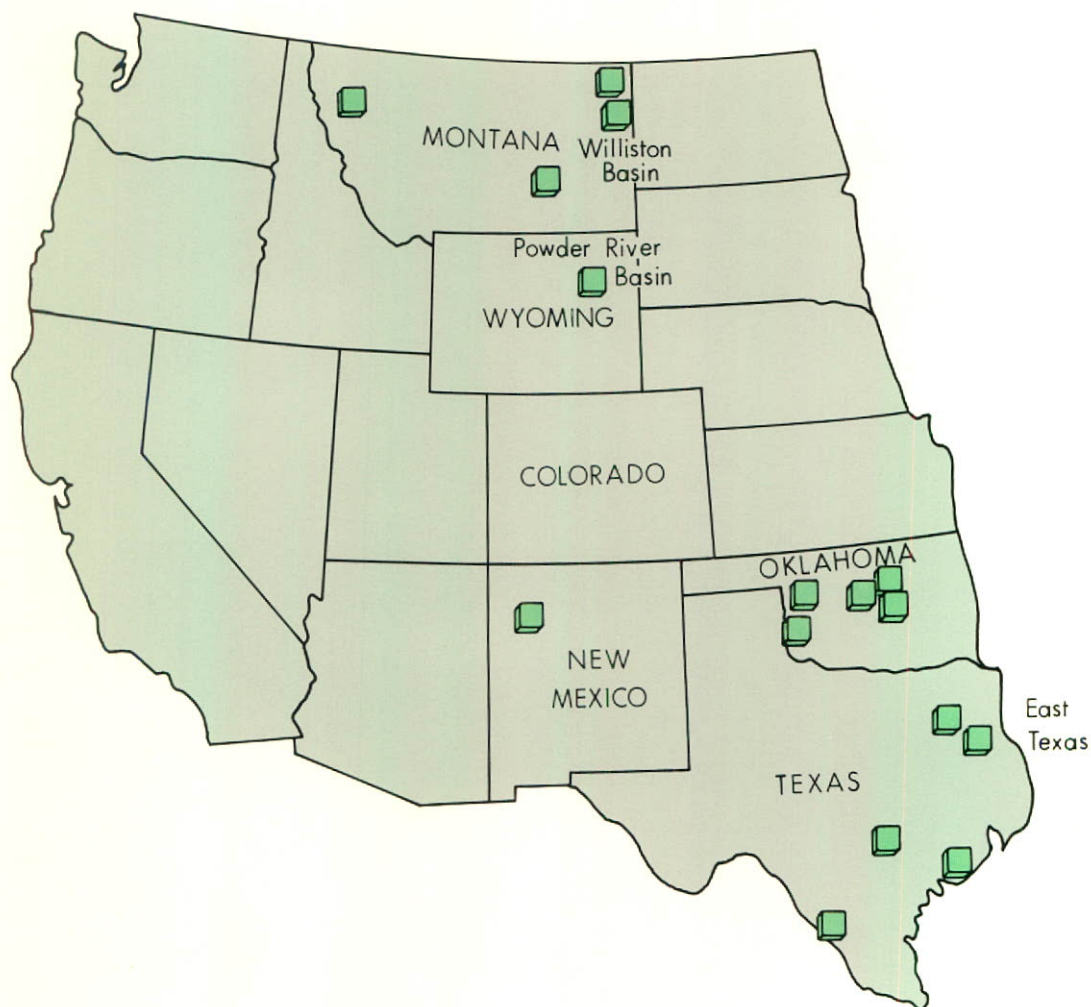




RATTLESNAKE AREA

- | | |
|--|---|
| DYNEX INTEREST LAND | ● BLACKROCK WELLS |
| ○ LOCATION | ✱ GAS WELL |
| | ✱ DRY & ABANDONED |

WESTERN UNITED STATES

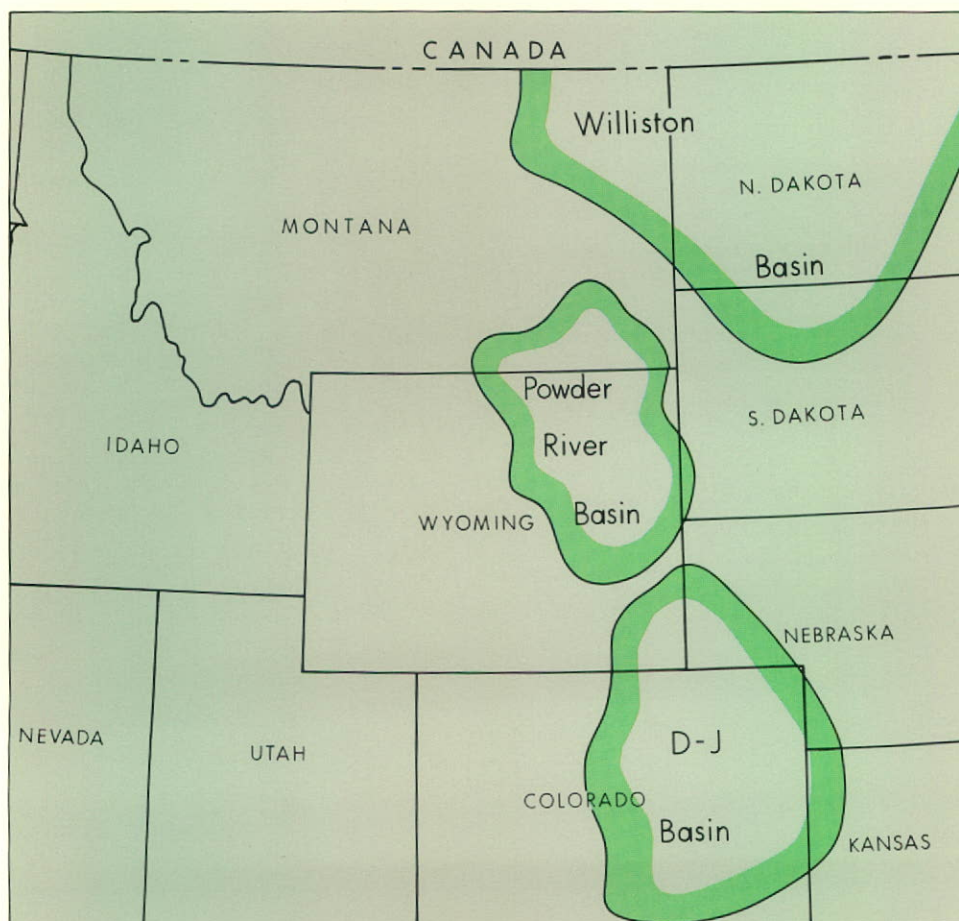


Oklahoma — Canadian County

The Company has negotiated the sale of the 11 producing wells in Canadian County, Oklahoma. The working interests held by Dynex range from 5 percent to 26 percent. The proceeds of the sale of these properties will cut overhead costs and reduce bank debt. The terms and conditions of the proposed sale are subject to the February 1983 closing for total proceeds of approximately U.S. \$500,000.

Cashion Gas Plant

The sale of the Oklahoma Cashion Gas Plant and facilities was successfully concluded on December 1, 1982 for a total price of U.S. \$2.7 million. Dynex has received 50 percent of the funds to date with the balance due June 1, 1983. The funds from the sale will be used to reduce bank debt.

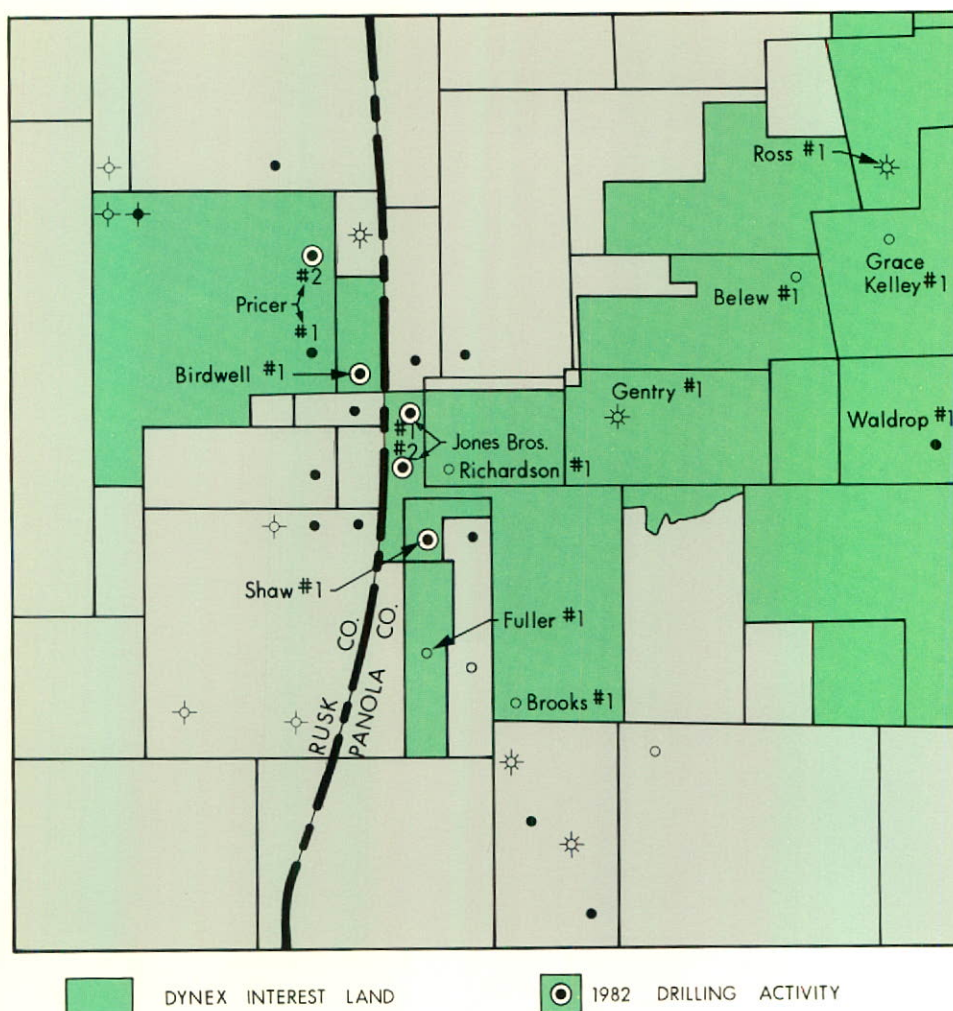


Rocky Mountain Area — Wyoming Powder River Basin

The future exploration efforts of Dynex Energy will concentrate in the Powder River Basin of Wyoming. This area has been chosen because of its relatively shallow drilling depth, excellent per well reserves and the fact that the basin is oil prone. Numerous oil prospects have been generated by our geologists and plans are being formulated to provide a program of selective lease acquisition.

Montana

Several prospects have been delineated in the shallow, western portion of the Williston Basin and several leases have been acquired. A modest seismic program is being interpreted which should lead to additional prospect inventory.



East Texas

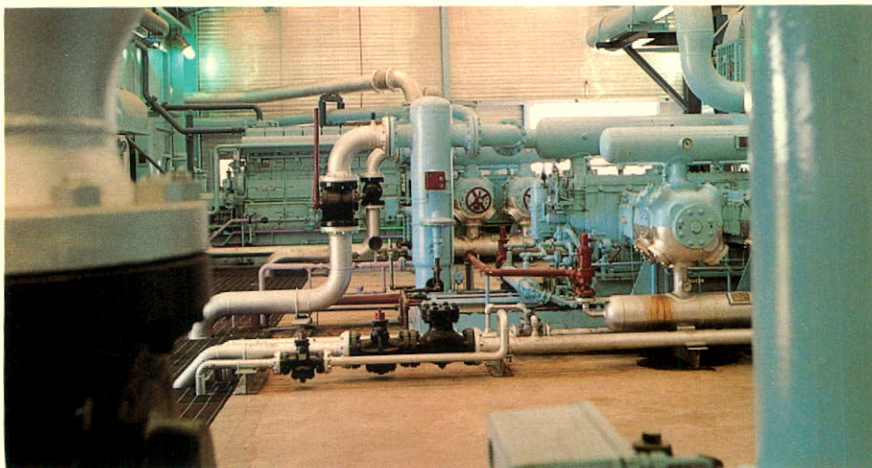
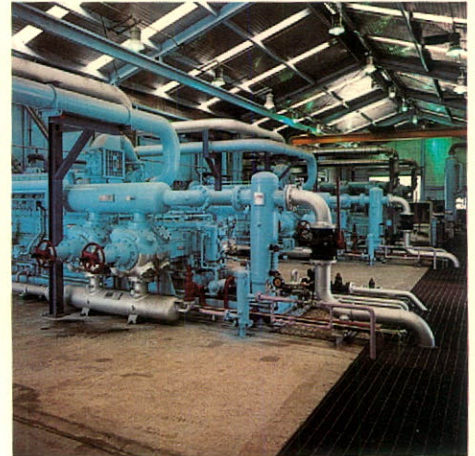
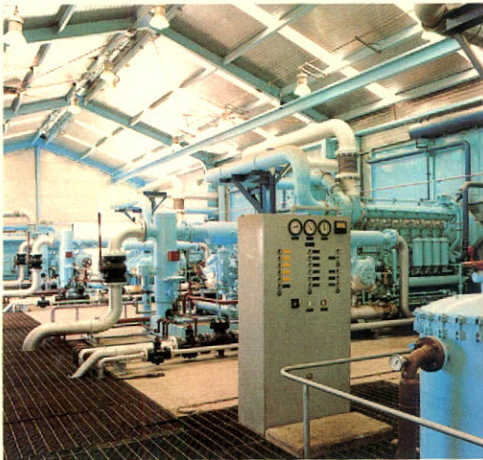
All of the drilling activity of Dynex Energy Inc. for the seven month period ending December 31, 1982 was concentrated in Rusk and Panola counties of East Texas. Two Travis Peak gas wells drilled in the previous reporting period were successfully completed and put on production. The H. T. Gentry #1 and D. Ross #1 were drilled at no cost to Dynex with Dynex retaining a 23.75 percent working interest in each well. Respectively, the wells flowed 1.0 MMCF/D with 15 barrels of condensate and 1.2 MMCF/D with 25 barrels of condensate. All five oil wells produce from the Lower Cretaceous Pettet zone at an average depth of 7,000 feet. The recent drilling activity in the East Texas area illustrates our philosophy of receiving the best value possible per dollar expended without being exposed to excessive risk. This philosophy is evidenced by the working

interests maintained in the five successful Pettet oil wells which were drilled and completed at very little cost to Dynex. These producing Pettet zone oil wells flow tested at volumes of 43 to 111 BOPD and presently flare between 100 MCF/D and 250 MCF/D of natural gas. Subsequent to year end, a gas contract was negotiated with gas sales commencing March 15, 1983. This gas conservation project should gross an additional \$79,000 per month assuming an average 200 MCF/D per well and receipt of section 102 gas price of \$3.20/MCF.

A minimum of four additional locations are to be drilled in 1983 on the remaining leases with a potential of at least ten additional wells.

LAND HOLDINGS
at December 31, 1982

	Developed		Undeveloped	
	Gross	Net	Gross	Net
CANADA				
Alberta	123,090	51,382	111,984	39,569
British Columbia	1,347	333	24,363	8,191
Total — Canada	124,437	51,715	136,347	47,760
UNITED STATES				
Montana	1,040	320	8,907	4,010
Wyoming	160	36	1,429	372
Oklahoma	3,663	1,168	1,780	668
New Mexico	320	72	320	32
Texas:				
East Texas Project Area	7,494	3,565	3,499	2,092
Other	879	244	44,003	19,720
Total — United States	13,556	5,405	59,938	26,894
TOTAL	<u>137,993</u>	<u>57,120</u>	<u>196,285</u>	<u>74,654</u>



Production

A total 3.15 BCF of gas was produced during the seven months with 86 percent in Canada and 14 percent in the U.S. Production of crude oil and natural gas liquids totalled 86,811 barrels, 66 percent in Canada and 34 percent in the U.S. Oil production increased by 8 percent to 406 BOPD while natural gas production decreased 27 percent to 14.71 MMCF/D.

Canadian gas sales were affected by the large cut-back of our major gas purchaser, TransCanada Pipe-Lines Ltd. (T.C.P.L.), who reduced their "takes" by approximately 40 percent. Dynex agreed to the T.C.P.L. Topgas Allocation Agreement which reduced the "take-or-pay" obligations from 90 to 60 percent in exchange for two lump sum payments totalling \$6,384,000. Recovery of "take-or-pay" volumes is expected to commence in late 1984.

Subsequent to the year end, the National Energy Board ruled that a surplus of Canadian gas exists and therefore approved many export applications. Most of Dynex's shut-in reserves are dedicated to two new purchasers, KannGaz and ProGas. Since additional

sales to the U.S. are not expected until 1984, Dynex has negotiated short term discounted gas contracts for various terms up to one year. These best efforts contracts contain volumes up to 10 MMCF/D. During the seven month fiscal period, sales to the short term customers averaged 3.4 MMCF/D.

Oil production in Canada increased from 173 to 266 BOPD due to the removal of Federal restrictions and therefore full nominations.

Oil production in the U.S. decreased by 62 BOPD as a result of productivity decreases in Oklahoma and Texas and the new wells in East Texas not going on stream until the latter part of the year.

U.S. gas production increased by 48 percent to 2.03 MMCF/D following completion of the Travis Peak wells in East Texas. This trend should continue in 1983 when the Pettet Solution gas is connected. Oklahoma production will decrease significantly due to the sale of the Canadian County properties and the roll-in of the Kingfisher properties.

Reserves

The following table of reserves summarizes and compares the volumes of oil and gas and the present worth values assigned thereto as at December 31, 1982 and May 31, 1982. All reserves and values are determined by independent petroleum engineers based on their studies of performance characteristics and volumetric determination of reservoirs.

The corporate reserves and present worths have decreased significantly as a result of lower price forecasts, harsher treatment by the consultants, restricted

U.S. gas markets, sale of certain U.S. properties and several revisions to the Canadian-Alberta National Energy Program policies.

The corporate discounted present worth at 15 percent has decreased by 25 percent from \$178.2 million to \$133.9 million. On a present worth basis approximately 91 percent of the Company's Canadian net reserves and 71 percent of the U.S. reserves are presently producing.

CORPORATE RESERVES

	Gross		Net		Present Worth \$MM at 15%	
	Dec. 31	May 31	Dec. 31	May 31	Dec. 31	May 31
NATURAL GAS (BCF)						
Proven						
Canada.....	221.8	253.9	85.6	96.7	\$109.1	139.0
Texas	1.8	3.6	1.2	1.1	3.0	3.1
Other U.S.	2.0	9.3	0.5	1.4	1.0	2.9
TOTAL PROVEN	225.6	266.8	87.3	99.2	113.1	145.0
Probable						
Canada.....	3.5	8.8	1.3	1.6	2.8	3.4
Texas	1.0	4.7	0.2	1.9	0.3	6.5
Other U.S.	1.0	1.0	0.4	0.4	0.8	0.6
TOTAL PROBABLE	5.5	14.5	1.9	3.9	3.9	10.5
TOTAL GAS	231.1	281.3	89.2	103.1	117.0	155.5
CRUDE OIL AND NATURAL GAS LIQUIDS (BBLs x 1,000)						
Proven						
Canada.....	6,468.6	6,480.2	544.7	681.4	10.4	12.2
Texas	628.2	197.5	64.8	36.6	1.0	1.4
Oklahoma.....	115.7	565.1	40.7	102.8	0.2	2.1
Wyoming	163.8	199.2	19.3	23.8	0.4	0.5
Other U.S.	65.7	92.7	0.5	0.7	—	—
TOTAL PROVEN	7,442.0	7,534.7	670.0	845.3	12.0	16.2
Probable						
Canada.....	7,630.4	2,267.3	266.1	403.2	3.9	6.0
Texas	8.2	30.9	1.7	10.7	—	—
Oklahoma.....	58.3	41.8	24.7	17.7	0.5	—
Wyoming	294.1	296.3	35.7	37.4	0.5	0.5
TOTAL PROBABLE	7,991.0	2,636.3	328.2	469.0	4.9	6.5
TOTAL OIL	15,433.0	10,171.0	998.2	1,314.3	16.9	22.7
TOTAL PRESENT WORTH					\$133.9	178.2

Gross reserves are the total reserves for projects in which the Company has a working interest. The net reserve values are net to the Company's working interest after deduction of royalties and allowance for the production taken during the year.

FIVE YEAR OPERATIONS SUMMARY

	Seven Months Ended December 31, 1982	Year Ended May 31,			
		1982	1981	1980	1979
GROSS PRODUCTS SALES					
Natural Gas — MMCFD					
Canada/U.S.	14.71	20.21	18.05	16.01	14.28
Crude Oil — BOPD					
Canada/U.S.	405.7	374.7	320.0	132.0	72.0
AVERAGE SALE PRICE					
Natural Gas \$/MCF	2.919	2.588	2.427	2.056	1.535
Crude Oil \$/Bbl.	31.00	31.15	26.52	14.04	12.68
TOTAL RESERVES — After Royalties					
Natural Gas — BCF	89	103	104	81	74
Crude Oil — Bbls. x 1,000	998.0	1,314.0	1,494.0	950.0	830.0
LAND HOLDINGS					
Canada					
— Gross Acres	260,784	264,921	239,900	210,101	117,155
— Net Acres	99,475	110,701	108,100	96,197	57,156
United States					
— Gross Acres	73,494	89,120	112,300	128,066	—
— Net Acres	32,299	37,736	51,000	58,267	—
Total					
— Gross Acres	334,278	354,041	415,200	338,167	117,155
— Net Acres	131,774	148,437	165,400	154,464	57,156
WELLS DRILLED					
Gas	29	9	47	48	33
Oil	8	11	30	19	1
Dry	2	8	19	11	8
Total	39	28	96	78	42

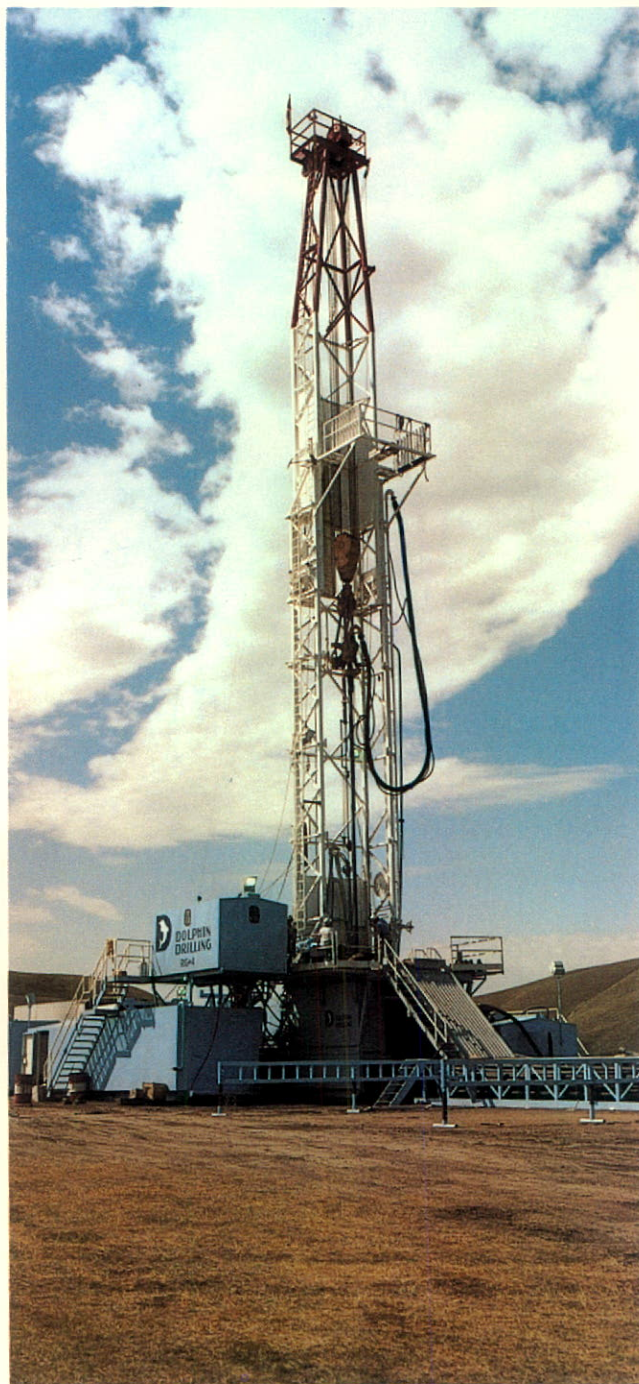
Drilling Division

Dolphin has continued its excellent reputation for well maintained equipment and has increased its clientele of independent Canadian companies. The division had an activity level of 60 percent of available rig time during the seven months, which is 88 percent better than the industry activity level of 32 percent.

During the seven month period ended December 31, 1982, Dolphin drilled 167 wells for a total of 402,215 feet or an average depth per well of 2,408 feet. In comparison, for the year ended May 31, 1982, Dolphin drilled 231 wells for a total footage of 580,458 feet.

Operating revenue for the drilling division for the current fiscal period was \$3,830,000 compared to \$7,230,000 for the year ended May 31, 1982. Despite a 23.6 percent decrease in operating revenue per drilling foot from the previous fiscal period, the drilling division increased gross margin after direct contract costs to 42 percent from the 36 percent reported at May 31, 1982. This was achieved through stringent cost controls and efficient operations. As a consequence, segmented operating profit of \$190,000 remained at the 47 cents per drilling foot previously reported at May 31, 1982.

Although low utilization and intensive competition are expected to characterize the drilling industry this year, we are optimistic that well maintained equipment, excellent staff and Dolphin's reputation in the industry will make 1983 a successful year with slight increases in both utilization and profits.



FINANCIAL REVIEW

For the seven month fiscal period ended December 31, 1982, the Company had a loss of \$2,103,000 (\$0.14 per share) compared to a net loss of \$5,935,000 (\$0.40 per share) for the previous fiscal year ended May 31, 1982. The results for the previous year included an extraordinary gain of \$243,000 on the sale of Dalco Petroleum Corporation shares. There were no extraordinary items in the current reporting period. Results for the current and previous fiscal period also include a loss of \$127,000 and \$1,863,000 respectively associated with a discontinued operation.

Revenue

Operating revenue for the seven month fiscal period was \$24.4 million compared to \$36.4 million for the previous twelve month period. The divisional results are summarized in the accompanying table of Comparative Results by Operating Segments.

Revenue from oil and gas operations was \$7.7 million for the seven month period versus \$12.7 million for the previous year. Production of natural gas in the current reporting period averaged 14,713 mcf per day compared to 20,212 mcf per day for the previous twelve month fiscal period, a reduction of 27.2 percent. Reduced production volumes in Canada arising from declining export sales more than offset increased gas production volumes associated with our U.S. operation. Average gas prices, which increased 12.8 percent to \$2.919 per mcf in the current reporting period, also had a moderating impact on reduced gas revenue. Oil production increased 8.6 percent to an average daily rate of 406 barrels for the seven month fiscal period. The seven month results include a 53.8 percent increase in Canadian oil production reflecting a partial resolution of the oil pro-rationing problem experienced in the previous fiscal period. U.S. oil production, through normal declines in productivity, however, decreased 30.3 percent to 140 barrels per day. Despite falling crude prices worldwide, the average price of oil remained at \$31 per barrel.

The curtailment of natural gas exports to the United States caused a shortage of certain LPG products, particularly butane, in the seven months ended December 31, 1982. This resulted in both higher daily sales volumes and average product prices in the current fiscal period. Revenue for the marketing division was \$12.9 million versus \$16.4 million for the year ended May 31, 1982.

The drilling division continues to be very competitive with low activity levels prevailing throughout the industry. Dolphin Drilling's excellent reputation, however, has enabled the Company to maintain above average rig utilization rates. For the seven months ended December 31, 1982, rig utilization was 60 percent, almost double the industry average of 32 percent. In the previous twelve months, rig utilization was 67 percent. Drilling revenue was \$3,830,000 in the current fiscal period versus \$7,230,000 for the previous year on total footage drilled of 402,215 feet and 580,458 feet respectively.

Expenses

Operating costs of sales were \$17.7 million in the current reporting period compared to \$25.3 million for the year earlier.

Operating cost of sales for the oil and gas division in the current period was \$2.1 million, 27.1 percent of divisional operating revenue. For the year ended May 31, 1982, operating cost of sales of \$3.1 million was 24.1 percent of divisional operating revenue. The apparent increase in operating cost of sales for the oil and gas division reflects the increased proportion of oil revenue, which tends to have higher operating costs, to gas revenue in the current reporting period. In addition, the 27.2 percent reduction in daily gas sales did not result in a corresponding decrease in costs as certain operating expenses tend to be fixed in nature.

COMPARATIVE RESULTS BY OPERATING SEGMENTS

(000's of \$)

	Canada		United States		Total	
	Seven Months Ended December 31/82	Year Ended May 31/82	Seven Months Ended December 31/82	Year Ended May 31/82	Seven Months Ended December 31/82	Year Ended May 31/82
Operating Revenue						
Oil and gas.....	\$ 5,482	9,375	2,187	3,360	7,669	12,735
Marketing	12,882	16,025	—	382	12,882	16,407
Drilling	3,830	7,230	—	—	3,830	7,230
	<u>\$22,194</u>	<u>32,630</u>	<u>2,187</u>	<u>3,742</u>	<u>24,381</u>	<u>36,372</u>
Operating Cost of Sales						
Oil and gas.....	\$ 1,183	1,625	895	1,439	2,078	3,064
Marketing	12,414	15,489	—	499	12,414	15,988
Drilling	3,195	6,235	—	—	3,195	6,235
	<u>\$16,792</u>	<u>23,349</u>	<u>895</u>	<u>1,938</u>	<u>17,687</u>	<u>25,287</u>

Note:

Results for the year ended May 31, 1982 have been restated to adjust for the sale and discontinued operation of the Company's gas processing plant in the United States.

Cost of sales for the marketing division expressed as a percent of divisional operating revenue were 96.4 percent compared to 97.4 percent the previous fiscal period. Divisional cost of sales for the current and immediately preceding reporting periods were \$12.4 million and \$16 million respectively.

Significant cost reductions by the drilling division were realized in the seven months ended December 31, 1982. Operating cost of sales of \$3.2 million, 83.4 percent of divisional revenue, compares favourably to the \$6.2 million in cost of sales, 86.2 percent of operating revenue, for the previous fiscal period. These results were achieved despite a 24 percent reduction in drilling revenue per foot drilled.

Interest expense in the current fiscal period was \$5.9 million versus \$11.9 million for the year earlier. Average long term debt outstanding of \$62.9 million was 2.8 percent higher than the \$61.2 million for the previous year. Average effective interest rates, however, declined to 15.9 percent from 19.4 percent, a reduction of 18 percent.

In the current fiscal period, depletion, depreciation and amortization were \$2.9 million in the aggregate versus \$4 million for the immediately preceding twelve months. Lower daily production volumes in the current reporting period were offset by an increase in the de-

pletion and depreciation rate per equivalent unit of production. Furthermore, results for the seven months ended December 31, 1982 include a non-recurring writedown of \$277,000 on certain property interests.

Changes in Financial Position

For the seven months ended December 31, 1982, the Company had cash flow of \$162,000 compared to a cash flow deficiency of \$2.1 million in the immediately preceding fiscal period. During the current period, the Company received \$6.4 million in "take-or-pay" payments from TransCanada PipeLines. Proceeds on sale of property, plant and equipment contributed an additional \$3.2 million in working capital resulting in a total source of funds available for capital expenditures and debt retirement of \$9.8 million.

Capital expenditures were \$2.3 million versus \$13 million for the preceding year. Repayment of long term debt for the current period totalled \$4.8 million and working capital at December 31, 1982 increased \$2.5 million to \$3.9 million from that reported at May 31, 1982.

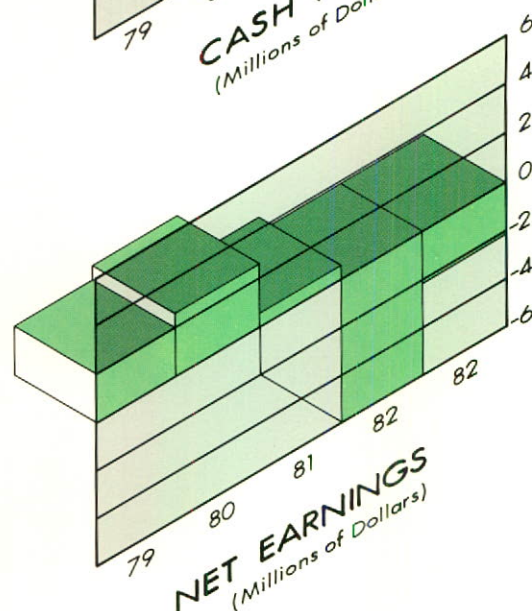
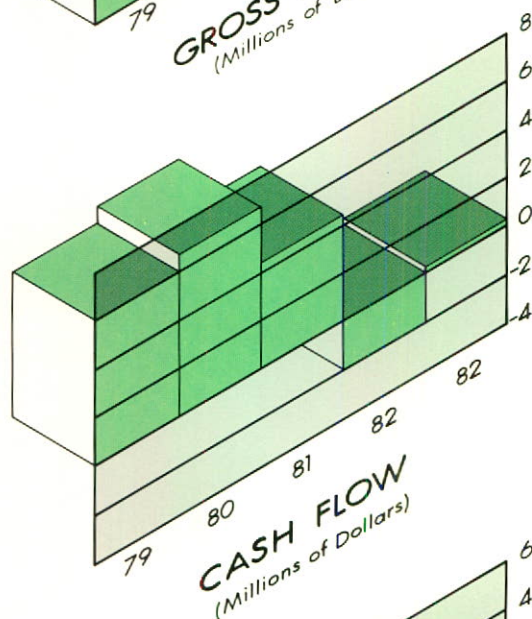
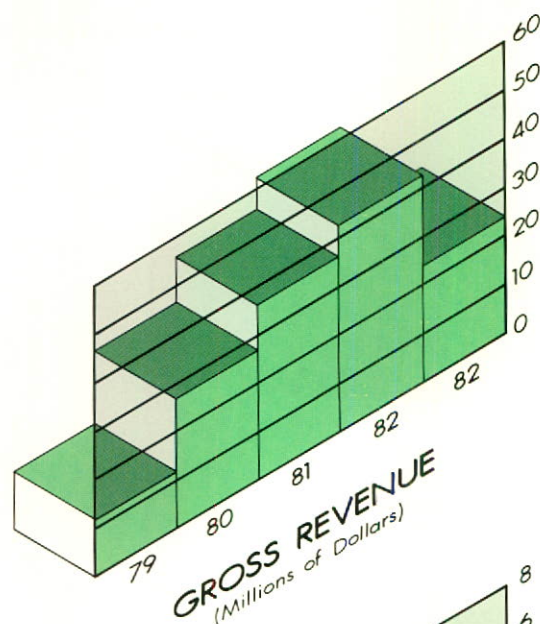
Financial Outlook

Despite the soft markets which presently exist for natural gas, the Company is cautiously optimistic about its prospects for 1983.

Canadian prime interest rates have declined to 11 percent from the 12.5 percent level at year end. U.S. prime is currently at 10.5 percent. These rates compare favourably to the effective borrowing rate of 15.9 percent incurred by the Company in the fiscal period just ended.

In order to sustain the economic recovery which is currently under way, indications are that interest rates may continue to drop even further before reaching a plateau. It is conceivable that U.S. prime could decline to single digits and Canadian prime to the 10 percent level. These interest rate reductions will result in increased levels of cash flow in 1983.

The Company is also investigating other means to strengthen its balance sheet and its ability to generate cash flow. Options being reviewed, which are not mutually exclusive, include additional property dispositions to reduce debt, corporate or property acquisitions for equity to strengthen corporate cash flow and potential equity or convertible debt financings.



Five Year Financial Summary

	Seven Months Ended December 31, 1982	Year Ended May 31,			
		1982	1981	1980	1979
		(restated)	(restated)	(restated)	(restated)
Revenue					
Oil and gas	\$ 7,669,000	12,735,000	11,201,000	7,203,000	4,356,000
Marketing	12,882,000	16,407,000	13,701,000	13,628,000	4,003,000
Drilling	3,830,000	7,230,000	7,678,000	6,024,000	3,278,000
Operating revenue	24,381,000	36,372,000	32,580,000	26,855,000	11,637,000
Other	157,000	618,000	681,000	720,000	1,108,000
	24,538,000	36,990,000	33,261,000	27,575,000	12,745,000
Costs, expenses and taxes					
Operating cost of sales	17,687,000	25,287,000	20,501,000	16,798,000	6,062,000
General and administrative	1,510,000	2,904,000	2,820,000	2,238,000	1,656,000
Interest	5,886,000	11,873,000	5,914,000	2,387,000	1,369,000
Depletion, depreciation and amortization	2,654,000	3,639,000	3,550,000	2,067,000	1,115,000
Loss (gain) on foreign exchange	36,000	(304,000)	(93,000)	(10,000)	40,000
Loss on discontinued operation	127,000	1,863,000	372,000	—	—
Taxes	(1,259,000)	(2,094,000)	(356,000)	1,057,000	463,000
	26,641,000	43,168,000	32,708,000	24,537,000	10,705,000
Earnings (loss) before extraordinary item	(2,103,000)	(6,178,000)	553,000	3,038,000	2,040,000
Extraordinary item	—	243,000	—	—	—
Net earnings (loss)	\$ (2,103,000)	(5,935,000)	553,000	3,038,000	2,040,000
Earnings (loss) per share					
Before extraordinary item	\$(0.14)	(0.42)	0.04	0.23	0.16
After extraordinary item	\$(0.14)	(0.40)	0.04	0.23	0.16
Funds provided by (applied to) operations	\$ 162,000	(2,104,000)	4,278,000	6,643,000	2,916,000
Capital employed					
Working capital (deficiency)	\$ 3,941,000	1,436,000	3,771,000	(225,000)	181,000
Property, plant and equipment	69,748,000	70,217,000	66,256,000	34,228,000	14,461,000
Other	834,000	4,063,000	969,000	1,029,000	3,150,000
	\$74,523,000	75,716,000	70,996,000	35,032,000	17,792,000
Capital employed comprised of					
Long-term debt	\$57,942,000	62,789,000	51,434,000	16,693,000	12,358,000
Deferred revenue	\$11,216,000	4,949,000	4,576,000	3,667,000	2,908,000
Deferred income taxes	\$ 1,655,000	2,165,000	3,040,000	2,864,000	1,465,000
Shareholders' equity	\$ 3,710,000	5,813,000	11,946,000	11,808,000	1,061,000
Common shares outstanding (1)	14,780,000	14,780,000	14,780,000	14,700,000	10,000,000
Capital expenditures					
Acquisitions and land retention	\$ 538,000	1,617,000	7,255,000	8,484,000	2,332,000
Geological and geophysical	648,000	1,407,000	1,354,000	630,000	—
Drilling and equipping	1,010,000	9,188,000	24,914,000	7,208,000	1,753,000
Cost of finding and developing reserves	2,196,000	12,212,000	33,523,000	16,322,000	4,085,000
Other	102,000	840,000	2,246,000	5,376,000	2,129,000
	\$ 2,298,000	13,052,000	35,769,000	21,698,000	6,214,000

(1) Restated to reflect stock dividends declared May 29, 1981 on the basis of one dividend share for every common share issued.

(2) Certain figures for prior years have been reclassified to conform with the financial statement presentation adopted for 1982.

Consolidated Statement of Earnings and Retained Earnings

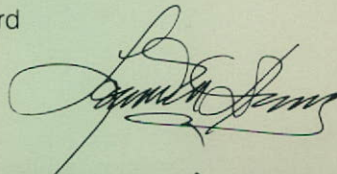
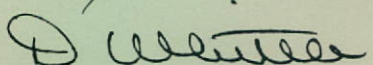
	Seven Months Ended December 31, 1982	Year Ended May 31, 1982 (restated)
Revenue		
Operating	\$24,381,000	\$36,372,000
Interest and other	157,000	618,000
	<u>24,538,000</u>	<u>36,990,000</u>
Expense		
Operating cost of sales	17,687,000	25,287,000
General and administrative	1,510,000	2,904,000
Interest on long-term debt	5,886,000	11,873,000
Depletion	1,837,000	2,592,000
Depreciation and amortization	817,000	1,047,000
Loss (gain) on foreign exchange	36,000	(304,000)
	<u>27,773,000</u>	<u>43,399,000</u>
Loss from continuing operations before extraordinary item	3,235,000	6,409,000
Loss on discontinued operation (Note 11)	127,000	1,863,000
Loss before taxes and extraordinary item	<u>3,362,000</u>	<u>8,272,000</u>
Taxes (Note 6)		
Petroleum and gas revenue tax	244,000	969,000
Incremental oil revenue tax	—	30,000
Alberta royalty tax credit	(993,000)	(2,137,000)
Deferred income taxes	(510,000)	(956,000)
	<u>(1,259,000)</u>	<u>(2,094,000)</u>
Loss before extraordinary item	<u>2,103,000</u>	<u>6,178,000</u>
Extraordinary item		
Gain on sale of Dalco Petroleum Corporation shares, net of income tax of \$81,000	—	243,000
Net loss	<u>2,103,000</u>	<u>5,935,000</u>
Retained earnings (deficit), beginning of period (Note 7)	<u>(1,285,000)</u>	<u>4,650,000</u>
Deficit, end of period	<u>\$ 3,388,000</u>	<u>\$ 1,285,000</u>
Loss per share (based on weighted average number of shares outstanding)		
Loss before extraordinary item	<u>\$0.14</u>	<u>\$0.42</u>
Net loss	<u>\$0.14</u>	<u>\$0.40</u>

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheet

	1982	
	<u>December 31</u>	<u>May 31</u> (restated)
ASSETS		
Current assets		
Cash and short term deposits	\$ 3,821,000	\$ 2,508,000
Accounts receivable	14,039,000	10,276,000
Inventories	166,000	506,000
Prepaid expenses and other assets	228,000	63,000
Total current assets	<u>18,254,000</u>	<u>13,353,000</u>
Asset held for resale	—	3,333,000
Property, plant and equipment (Note 3)	83,849,000	81,944,000
Less accumulated depreciation and depletion	<u>14,101,000</u>	<u>11,727,000</u>
	69,748,000	70,217,000
Other assets (Note 4)	<u>834,000</u>	<u>730,000</u>
	<u><u>\$88,836,000</u></u>	<u><u>\$87,633,000</u></u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	\$13,713,000	\$ 9,440,000
Bank loan	—	1,877,000
Current portion of long-term debt	<u>600,000</u>	<u>600,000</u>
Total current liabilities	14,313,000	11,917,000
Long-term debt (Note 8)	57,942,000	62,789,000
Deferred revenue (Note 5)	11,216,000	4,949,000
Deferred income taxes	1,655,000	2,165,000
Shareholders' equity		
Share capital (Note 9)	9,822,000	9,822,000
Deficit	(3,388,000)	(1,285,000)
Receivable from employees in respect of share purchase plans (Note 10)	<u>(2,724,000)</u>	<u>(2,724,000)</u>
	3,710,000	5,813,000
Commitments and contingencies (Notes 12 and 13)		
	<u><u>\$88,836,000</u></u>	<u><u>\$87,633,000</u></u>

On behalf of the Board

 Director
 Director

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

	Seven Months Ended December 31, 1982	Year Ended May 31, 1982 (restated)
Working capital derived from		
Operations		
Loss before extraordinary item	\$(2,103,000)	—
Depreciation, depletion and amortization	2,869,000	—
Deferred income taxes	(510,000)	—
Deferred revenue — product exchange	(94,000)	—
Funds provided from operations	162,000	—
Deferred natural gas revenue	6,361,000	704,000
Proceeds on sale of property, plant and equipment	3,233,000	520,000
Increase in long-term debt	—	12,702,000
Proceeds on sale of Dalco Petroleum Corporation shares	—	374,000
	<u>9,756,000</u>	<u>14,300,000</u>
Working capital applied to		
Operations		
Loss before extraordinary item	—	6,178,000
Depletion, depreciation and amortization	—	(4,000,000)
Provision for write-down of gas processing plant	—	(1,361,000)
Deferred income taxes	—	956,000
Deferred revenue — product exchange	—	331,000
Funds applied to operations	—	2,104,000
Repayment of long-term debt	4,847,000	1,347,000
Additions to property, plant and equipment	2,298,000	13,052,000
Other	106,000	132,000
	<u>7,251,000</u>	<u>16,635,000</u>
Working capital		
Increase (decrease) in working capital	2,505,000	(2,335,000)
Working capital, beginning of period	1,436,000	3,771,000
Working capital, end of period	<u>\$ 3,941,000</u>	<u>\$ 1,436,000</u>

See accompanying notes to consolidated financial statements.

Auditors' Report

To the Shareholders
 Dynex Petroleum Ltd.

We have examined the consolidated balance sheet of Dynex Petroleum Ltd. as at December 31, 1982 and the consolidated statements of earnings and retained earnings and changes in financial position for the seven month period then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the Company as at December 31, 1982 and the results of its operations and the changes in its financial position for the period then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Canada
 April 8, 1983

Peat, Marwick, Mitchell & Co.
 Chartered Accountants

Notes to Consolidated Financial Statements

Seven Months Ended December 31, 1982

1. Change of Year End

During the period, the Company received approval to change its fiscal year end to December 31. The change was made to provide greater comparability of financial and operating results with other companies in the petroleum industry and to facilitate financial and government reporting requirements.

2. Summary of Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned U.S. subsidiary, Dynex Energy Inc. Approximately 66 percent of all issued and outstanding shares of the Company are owned by Dalco Petroleum Corporation.

(b) Foreign Currency Translation

Foreign currency balances included in the consolidated financial statements have been translated to Canadian dollars on the following basis:

Current assets and liabilities — at the year end rate of exchange.

Other assets and liabilities — at exchange rate in effect at the date of transaction.

Revenue and expense — at the average rate of exchange for the period except depletion, depreciation and amortization which are translated on the same basis as the related assets.

The resultant gains or losses are included in the statement of earnings and retained earnings.

(c) Oil and Gas Operations

The Company follows the full cost method of accounting for petroleum and natural gas properties and related expenditures, under which all costs related to the exploration and development of petroleum and natural gas reserves are capitalized into one North American cost centre. Such costs include those related to lease acquisitions and retention, geological and geophysical activities including overhead related to exploration and the costs of drilling productive and non-productive wells.

Depletion of petroleum and natural gas properties and depreciation of production equipment are calculated on the unit-of-production method based upon estimated net proven developed reserves as determined by independent engineers.

Other equipment is depreciated as follows:

Automotive	30% declining balance
Furniture and fixtures	20% declining balance
Leasehold improvements	20% declining balance
Drilling rigs and equipment	10-30% declining balance

Substantially all of the Company's petroleum and natural gas exploration and production activities are conducted jointly with others and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

(d) Inventories

Inventories of liquefied petroleum gas products and materials and supplies are stated at the lower of average cost and current replacement cost.

(e) **Liquefied Petroleum Gas (LPG) Operations**

Revenue and costs related to the sale, purchase or trading in LPG products are recognized at the time of passage of title, as specified in the related agreements. Passage of title generally takes place upon completion of a particular product move.

(f) **Deferred Natural Gas Revenue**

Deferred natural gas revenue represents amounts received pursuant to "take-or-pay" natural gas contracts. These amounts have been deferred pending recovery through future gas deliveries.

(g) **Investment Tax Credits**

Income tax expense is reduced by the flow through of allowable investment tax credits.

(h) **Basis of Presentation**

Dynex Petroleum Ltd. is the result of a statutory amalgamation of M-P Petroleum Ltd. (M-P), Aldis Petroleum Ltd. (Aldis), D & D Drilling (D & D), and Yarmouth Petroleum Ltd. (Yarmouth), on May 31, 1979.

Certain of the following Notes to Consolidated Financial Statements may refer to specific predecessor corporations where the distinction is deemed to be of significance in its disclosure.

(i) **Comparative Figures**

Certain of the May 31, 1982 comparative figures have been reclassified to conform with the financial statement presentation adopted for the current fiscal period.

3. **Property, Plant and Equipment**

	December 31, 1982		May 31, 1982	
	Assets At Cost	Accumulated Depreciation and Depletion	Assets At Cost	Accumulated Depreciation and Depletion
Oil and gas interests including exploration and development costs thereon	\$65,787,000	\$ 9,547,000	\$64,226,000	\$ 7,710,000
Production equipment and related facilities	11,643,000	2,066,000	11,400,000	1,835,000
Drilling rigs and equipment	5,767,000	2,133,000	5,678,000	1,880,000
Other	652,000	355,000	640,000	302,000
	<u>18,062,000</u>	<u>4,554,000</u>	<u>17,718,000</u>	<u>4,017,000</u>
	<u>\$83,849,000</u>	<u>\$14,101,000</u>	<u>\$81,944,000</u>	<u>\$11,727,000</u>

4. **Other Assets**

	1982	
	December 31	May 31
Prepaid income taxes (Note 12)	\$ 607,000	\$ 607,000
Investment, at cost (no quoted market value)	76,000	76,000
Other	151,000	47,000
	<u>\$ 834,000</u>	<u>\$ 730,000</u>

5. Deferred Revenue

	1982	
	December 31	May 31
Deferred natural gas revenue	\$ 9,708,000	\$3,347,000
Deferred revenue — product exchange	1,508,000	1,602,000
	<u>\$11,216,000</u>	<u>\$4,949,000</u>

(a) Deferred Natural Gas Revenue

This represents amounts received for annual contracted gas volumes not taken by gas purchasers. During the period, \$6,473,000 was received from purchasers for contracted volumes not taken and \$112,000 was recovered through gas deliveries. For the year ended May 31, 1982 \$704,000 was received for contracted volumes not taken.

(b) Deferred Revenue — Product Exchange

	1982	
	December 31	May 31
Reduction in product exchange liability	\$ 6,116,000	\$ 6,116,000
Loss on underground storage construction contract	(1,044,000)	(1,044,000)
Overriding royalties — Odessa	(303,000)	(303,000)
Payment received under royalty agreement	200,000	200,000
Write-down of Dalco Petroleum, Inc. account (1976)	(1,857,000)	(1,857,000)
	3,112,000	3,112,000
Amortization	1,604,000	1,510,000
	<u>\$ 1,508,000</u>	<u>\$ 1,602,000</u>

In 1974 and 1975 a series of transactions were entered into with the El Paso Company (El Paso) and others, which transactions are accounted for as related transactions. Specifically, these transactions are:

- (i) Three LPG product exchange agreements between El Paso and M-P Petroleum Ltd. (M-P);
- (ii) The sale to Odessa Natural Gas Corporation (Odessa), a subsidiary of El Paso, of an 18% gross overriding royalty on a property owned by M-P; and
- (iii) The purchase by M-P from El Paso of its 50% interest in an underground storage project.

Product received under the LPG product exchange agreements referred to above was sold to an associated company, Dalco Petroleum Inc. An amount of \$1,857,000 relating to the product exchange agreements was receivable and included in the related transactions.

On September 9, 1976, pursuant to the LPG product exchange agreements, El Paso presented an invoice to the American Bank of Odessa for \$2,525,000 and subsequently received the escrowed funds, including interest. A mutual termination agreement relieved M-P of its obligation to return product thus extinguishing the liability for product payable of \$6,116,000.

The resultant gain on this transaction (\$6,116,000) has been reduced by deferred charges on the El Paso transactions and the resulting deferred revenue (\$3,112,000) is being amortized to income in amounts proportionate to royalty payments made under the Odessa agreement.

6. Taxes

Total taxes amounted to a recovery of \$1,259,000 for the seven months ended December 31, 1982 and a recovery of \$2,094,000 for the year ended May 31, 1982. The total is different from the expected amount computed by applying the combined expected Canadian federal and provincial tax rates to earnings (loss) before taxes and extraordinary item. The reasons for these differences are as follows:

	Seven Months Ended December 31, 1982	Year Ended May 31, 1982
Computed tax expense	\$(1,580,000)	\$(3,888,000)
Add (deduct):		
Disallowed payments to Crown, net of provincial rebates and credits	(311,000)	(504,000)
Loss of subsidiary	822,000	2,222,000
Petroleum and gas revenue tax	244,000	969,000
Resource allowance on resource profits	(810,000)	(1,357,000)
Other	376,000	464,000
	<u>\$(1,259,000)</u>	<u>\$(2,094,000)</u>

The Company had unused non-capital losses, capital losses and investment tax credit carry forwards as follows:

	1982	
	December 31	May 31
Non-capital loss	\$6,600,000	\$4,900,000
Capital loss	\$ 279,000	\$ 279,000
Investment tax credits	\$1,130,000	\$1,150,000

7. Restatement of Prior Periods

The Department of National Revenue has issued reassessments for taxes of \$600,000 and interest of \$115,000 relating to the 1977 fiscal year. Accounts payable, deferred income taxes and retained earnings at May 31, 1981 have been restated to reflect these reassessments. The effect on retained earnings is as follows:

	1982	
	December 31	May 31
Beginning of period, as previously reported	\$(1,170,000)	\$4,765,000
Provision for current income taxes	600,000	600,000
Reduction in deferred income taxes	(600,000)	(600,000)
Interest on reassessment	115,000	115,000
As restated	<u>\$(1,285,000)</u>	<u>\$4,650,000</u>

8. Long-Term Debt

The long-term debt of the Company is comprised of the following loans and contracts:

	1982	
	December 31	May 31
Demand bank loan, bearing interest at prime plus ½% with repayment in multiples of \$100,000 at the option of the Company, until January 1, 1984 followed by monthly payments over a term of up to 6¼ years. The bank loan is secured by a registered assignment of certain oil and gas properties under Section 177 of the Bank Act and a general assignment of book debts	\$ 3,600,000	\$36,700,000
Demand bank loan in the amount of U.S. \$300,000 at May 31, 1982, bearing interest at U.S. base rate plus ½% with repayment in multiples of \$100,000 at the option of the Company, until January 1, 1984 followed by monthly payments over a term of 6¼ years. The bank loan is secured by a registered assignment of certain oil and gas properties under Section 177 of the Bank Act and a general assignment of book debts	—	370,000
Notes payable	29,573,000	—
Demand bank loan in the amount of U.S. \$19,500,000 (May 31, 1982 — U.S. \$20,000,000), bearing interest at U.S. prime plus 1% with repayment in multiples of \$100,000 at the option of the Company, until January 1, 1984 followed by monthly payments over a term of up to 6¼ years. The bank loan is secured by a registered assignment of the Company's interest in hydrocarbons, equipment, accounts, contract rights, and other properties in the United States. The loan is also guaranteed by Dalco Petroleum Corporation and is secured by 4,000,000 common shares of Dynex Petroleum Ltd.	23,439,000	24,039,000
Finance contract, bearing interest at prime plus 1%, with a minimum of 10%, repayable in monthly instalments of \$50,000 together with interest until February, 1986. A debenture has been issued providing the finance company with a first specific charge on all drilling equipment, together with a floating charge on all other assets including the security of hydrocarbon reserves subject only to chartered bank security	1,850,000	2,200,000
Other	80,000	80,000
	58,542,000	63,389,000
Less current portion	600,000	600,000
	<u>\$57,942,000</u>	<u>\$62,789,000</u>

Notes payable of \$29,573,000 consists of Bankers' Acceptances maturing at various dates up to January 17, 1983 with a weighted average interest rate of 12.47 percent. These notes payable are shown as long-term debt because they are supported by the availability of term loans under the Company's Canadian revolving credit line.

During the year, the Company provided the Bank of Montreal with an additional guarantee of U.S. \$3,500,000 for advances made to an associated company. A debentureholder under the finance contract withheld consent for the granting of the guarantee. The Company has reserved \$1,950,000 of its existing Canadian revolving credit line to cover the technical default in the event the debentureholders exercise their prepayment rights under the terms of the debenture.

9. Share Capital

The authorized and issued share capital of the Company is as follows:

	Authorized		Issued	
	December 31, 1982	May 31, 1982	December 31, 1982	May 31, 1982
First Preference preferred shares of a nominal or par value of \$10 each	10,000,000	10,000,000	—	—
Second Preference preferred shares of a nominal or par value of \$1 each	144	144	144	144
Class A Voting Shares without nominal or par value	100,000,000	100,000,000	10,139,999	10,139,999
Class B Non-voting Shares without nominal or par value	100,000,000	100,000,000	4,640,001	4,640,001

The Second Preference preferred shares are only issuable to the directors of the Company and shall only be transferable with the prior written consent of the Company among and between the directors of the Company. The registered holders of the Second Preference preferred shares are entitled to 1,000 votes for each of these shares held.

The Class B Non-voting Shares are fully participating and rank equally with the Class A Voting Shares of the Company but have no voting privileges attached. The Class A Voting and Class B Non-voting Shares are inter-convertible on a one-for-one basis with the restriction that after conversion, the registered holder of Class B Non-voting Shares cannot be the registered owner of more than 50 percent of the then issued and outstanding Class A Voting Shares of the Company. This restriction shall be automatically waived in the event of a bonafide offer to purchase all or a major portion of the Class A Voting and Class B Non-voting Shares.

10. Employee Share Purchase Plan

The Company provided an interest-free five year advance on behalf of the employees to The Royal Trust Company (the "Trustee"), in 1981. During the period no shares were released with the cumulative number of shares at December 31, 1982 held in trust for the employees in this series totalling 448,800 shares with advances to the employees of \$2,126,000. These shares are held by the Trustee and were to be released to the employee purchaser subject to repayment of the proportionate amount of the term loan in amounts up to 20 percent annually on each anniversary of the Plan until December, 1985 at which time the employee loans relating to the Plan mature and become payable.

The Company, with the approval of the employees in the Plan, amended the Plan to temporarily discontinue the 20 percent annual "earning process". The Plan provides that to the extent the shares are not "earned" by the employees in the Plan, the Company is required to purchase the shares from the Trustee at the original share purchase price when the plan was originated.

In addition, the Trustee was authorized to purchase 80,000 Treasury shares at \$5 per share. The \$400,000 interest-free advances are repayable not later than November 30, 1986. The Plan requires the Company to purchase the shares at the purchase price of \$5 if the participants are no longer employees of the Company at December 1, 1985.

During the year ended May 31, 1982, the Company authorized the Trustee to purchase 50,900 shares on the open market at an aggregate cost of \$198,400. These shares remain unallocated to December 31, 1982.

As a result of the amendment to the "earning process" and the requirement of the Plan that the Company purchase shares from the Trustee under certain circumstances, the receivables from employees in respect of the share purchase plan in the amount of \$2,526,000 and the unallocated shares in the amount of \$198,000 have been classified as a reduction of shareholders' equity. In the event that the employees do not pay for shares which have been "earned" and the Company is required to purchase shares which have not been "earned", the share capital account will be charged with the average stated value of share capital of the Company purchased shares in the amount of \$486,000 and the remainder will be charged to retained earnings.

11. Discontinued Operation

During the period, the Company sold its gas processing plant located in the United States for a total consideration of \$3,118,000. The loss from discontinued operations can be summarized as follows:

	Seven Months Ended December 31, 1982	Year Ended May 31, 1982
Operating revenue	\$2,734,000	\$4,515,000
Operating cost of sales	2,646,000	4,656,000
Depreciation	215,000	361,000
Provision for write-down of gas plant	—	1,361,000
	<u>2,861,000</u>	<u>6,378,000</u>
Loss from discontinued operation	<u>\$ 127,000</u>	<u>\$1,863,000</u>

12. Commitments

The Company is committed under a lease for its Canadian office premises until February, 1985. The annual rental approximates \$104,000. The Company is committed under lease for its U.S. office premises until June, 1986. The annual rental approximates \$37,000 (U.S.).

The Company entered into lease agreements for the rental of LPG tank cars. The annual rental is approximately \$230,000 and the lease agreements expire between April, 1988 and February, 1990.

The Company has also entered into a lease agreement for the rental of a gas compressor in Canada. The annual rental is approximately \$88,000 to October, 1983 with annual payments of \$17,500 thereafter to the expiration of the lease in October, 1985.

13. Contingencies

(a) Bank guarantees

The Company is contingently liable as a guarantor for advances to associated companies in the amount of \$5,291,000 (U.S.).

(b) Income tax reassessments

Revenue Canada, Taxation has reviewed certain transactions entered into by a predecessor company during the years 1974 to 1976 (El Paso transactions) and as a result of such review, has assessed additional income taxes. On the advice of its tax counsel the Company has paid assessments in the amount of \$607,000, including interest of \$108,000. Concurrently, the Company has filed Notices of Objection and a Request for Competent Authority Consideration with Revenue Canada relative to certain of the items reassessed. The Company has provided income taxes relating to certain of these reassessed transactions.

In addition and related to the above transactions, Revenue Canada has reassessed for the years 1978-1979 in the amount of \$172,000 (excluding interest). The Company has also been assessed a non-resident withholding tax of \$442,000 including interest and penalty by Revenue Canada for failure to withhold monies from payments made to Dalco Petroleum Corporation in 1975-1977. On advice from tax counsel, the Company has recorded \$180,000 of the non-resident assessment. A Bank Letter of Guarantee has been obtained and provided to Revenue Canada for the non-resident withholding tax. The Company has filed Notices of Objection to certain of these assessments.

If the current reassessments are upheld, the Company would be required to provide for additional income taxes, however, since the ultimate resolution of the assessments is not determinable, no additional provision has been included in the consolidated financial statements. If the Company is not successful in its appeal, the additional income taxes will be charged to earnings in the respective periods in which the transactions occurred.

(c) Kansas lawsuit

The Company is a defendant in a lawsuit alleging conspiracy and wrongful diversion of corporate opportunity which lawsuit was originally filed in 1977 in the United States District Court of Kansas. The Company, however, was dismissed from the action after judgment in the amount of U.S. \$4.7 million was delivered against the Company's co-defendants. All parties to the action have, in a timely fashion, filed appeals from all aspects of the trial judgment including the dismissal of the Company; the Company's co-defendants have posted security in an amount in excess of the trial judgments.

The Court's dismissal of the Company has substantially reduced the probability that the Company may ever be required to make any expenditure in the lawsuit. In addition, Dalco Petroleum Corporation has agreed to indemnify the Company from any liability arising out of the legal proceedings described above.

(d) Drilling contract

The Company is a defendant in a lawsuit filed by a U.S. drilling contractor in October 1982 in the United States District Court of Colorado. The action seeks alleged damages up to U.S. \$2,394,000 plus interest for failure to make payment under the provisions of a daywork drilling contract entered into between the respective parties. The outcome of the lawsuit is not determinable and accordingly, no provision for loss has been recorded in the accounts.

14. Segmented Information (thousands of dollars)

The operations of the Company are divided into three business segments. Oil and gas includes the exploration for, and the development and production of petroleum and natural gas reserves. Marketing includes the purchase and resale of LPG products on the spot market and the drilling operations involve the activities of four drilling rigs in Canada.

Export sales to customers outside Canada were \$2,828,000 and \$5,426,000 for the seven months ended December 31, 1982 and the year ended May 31, 1982 respectively.

	Oil and Gas		Marketing		Drilling	Other		Consoli- dated
	Canada	U.S.	Canada	U.S.	Canada	Canada	U.S.	
Industry and Geographic December 31, 1982								
Revenue earned from outside the enterprise	\$ 5,482	2,187	12,882	—	3,830	134	23	24,538
Segmented operating profit	\$ 2,222	727	333	—	190	97	5	3,574
General corporate expenses ...								887
Interest expense								5,886
Loss on foreign exchange								36
Loss on discontinued operation								127
Taxes								(1,259)
								5,677
Net earnings (loss)								\$(2,103)
Identifiable assets	\$31,877	47,029	4,103	—	4,471	1,156	200	88,836
Capital expenditures	\$ 1,226	970	—	—	90	12	—	2,298
Depletion, depreciation and amortization	\$ 1,937	624	—	—	253	37	18	2,869
Industry and Geographic May 31, 1982								
Revenue earned from outside the enterprise	\$ 9,375	3,360	16,025	382	7,230	417	201	36,990
Segmented operating profit	\$ 5,045	1,441	105	(117)	273	417	201	7,365
General corporate expenses ...								2,205
Interest expense								11,873
Gain on foreign exchange								(304)
Loss on discontinued operation								1,863
Extraordinary item								(243)
Taxes								(2,094)
								13,300
Net earnings (loss)								\$(5,935)
Identifiable assets	\$33,411	43,537	1,532	3,333	4,688	1,020	112	87,633
Capital expenditures	\$ 2,673	9,580	—	376	350	41	32	13,052
Depletion, depreciation and amortization	\$ 2,475	450	117	—	483	77	37	3,639

15. Related Party Transactions

None of the Directors or Officers of the Company or any shareholder of the Company, and no associate or affiliate of any of them, has any material interest in any transaction which has materially affected or will materially affect the Company, other than the following, or as otherwise disclosed in the Notes to Consolidated Financial Statements:

- (a) Pursuant to an agreement dated June 1, 1978 Windermere Petroleum Ltd. ("Windermere") has the right to participate for up to 5 percent of the Company's interest on a working interest basis in any prospect. Conversely, the Company has the right to participate for up to 95 percent on a working interest basis in any prospect acquired by Windermere. Mr. W. R. Sharp, the President and controlling shareholder of Windermere, is the President and a Director of the Company.

Leprechaun Agencies Ltd. ("Leprechaun") has the right to participate in certain prospects entered into by the Company. Mr. M. L. Dea, the President and controlling shareholder of Leprechaun, is a Director and Executive Vice-President of the Company.

Wild Bull Petroleum Ltd. ("Wild Bull") has the right to participate in certain prospects entered into by the Company. Mr. R. D. Weir, Vice-President - Canadian Operations of the Company, is the President of Wild Bull.

The above companies have participated in certain lease acquisitions and exploration activities of the Company. Their participation is conducted under joint venture arrangements similar to unrelated industry partners.

During the seven months ended December 31, 1982 the Company acquired certain interests of Windermere and Leprechaun for a total consideration of \$429,000. The purchase price was determined from independent engineering evaluations of the properties involved.

Amounts owing from Windermere, Leprechaun, and Wild Bull in the amount of \$13,000 (May 31, 1982 — \$617,000) have been included in accounts receivable.

- (b) Pursuant to a management contract dated October 25, 1979, the Company is required to pay for all actual costs of Dalco Petroleum Corporation incurred in rendering management services to the Company up to a maximum of \$200,000 per annum. In addition, the Company has agreed to reimburse Dalco Petroleum Corporation for aircraft expenses which the Company may charter from time to time. The aggregate of these amounts totalling \$117,000 (May 31, 1982 — \$230,000) were charged to general and administrative expense.
- (c) The Company retained Dalco Services, Inc. for the operation of a gas plant in Kingfisher County, Oklahoma. During the period fees and recoverable expenses in the amount of \$76,000 (May 31, 1982 — \$252,000) were charged to earnings.
- (d) At December 31, 1982, Dalco Petroleum Corporation owed the Company \$1,141,000 (May 31, 1982 — \$973,000) while the Company owed \$580,000 (May 31, 1982 — \$621,000) to various subsidiaries of Dalco Petroleum Corporation. The net receivable has been classified as accounts receivable on the balance sheet.
- (e) During the period, the Company paid Dalco Petroleum Corporation a fee of \$168,000, including expenses of \$31,000 for negotiating the sale of the gas processing plant located in the United States.

16. Remuneration of Directors and Officers

The aggregate remuneration paid or payable to directors and senior officers (as defined by the Companies Act, Alberta, which term includes the five highest paid employees of the Company) during the period amounted to \$406,000 (May 31, 1982 — \$845,000).

17. Subsequent Event

By agreement dated January 1, 1983, the Company disposed of its Canadian LPG product marketing segment to a third party company of which one of the shareholders is an officer of the Company. Proceeds of the disposition are payable over a three year period and comprise:

- (a) 50 percent of pre-tax earnings, as defined in the agreement, until December 31, 1985 and
- (b) the assumption of a portion of the Company's existing obligation in respect of tank car rentals.

The Company has agreed to provide the purchaser with a revolving operating credit line of \$1,000,000 in 1983 declining to \$750,000 in 1984 and \$500,000 in 1985 at which time the credit facility will be terminated. The proceeds of disposition and the revolving line of credit are secured by a term debenture granting a first floating charge on all the assets of the purchaser.

Corporate Information

DIRECTORS

- †Lonnie M. Dunn — Chairman
 President and Chairman of the Board
 Dunoco Corporation
- †*Francis M. Parsons — Vice Chairman
 President
 Dalco Petroleum Corporation
- Murray L. Dea
 Executive Vice-President
 Dynex Petroleum Ltd.
- *John W. Ohanian, Jr.
 Executive Vice-President and Treasurer
 Dunoco Corporation
- *George W. Oughtred
 Chairman of the Board
 Commercial Oil & Gas Ltd.
- *William F. Procter
 Executive Vice President
 Gardiner Watson Ltd.
- †Wayne R. Sharp
 President
 Dynex Petroleum Ltd.
- Arthur R. Smith
 President
 Lavalin Services Inc.
 (Western Region)
- *Derek Whittle
 Co-Chairman
 The MerBanco Group

†Member of Executive Committee

*Member of Audit Committee

HEAD OFFICE

2001 Suncor Tower
 500 - 4th Avenue S.W.
 Calgary, Alberta
 T2P 2V6
 (403) 261-9810

SUBSIDIARY COMPANY

Dynex Energy Inc.
 215 Cherry Street Plaza 1
 600 So. Cherry Street
 Denver, Colorado 80222
 (303) 393-1400

OFFICERS

- Wayne R. Sharp
 President
- Murray L. Dea
 Executive Vice-President
- Deane G. H. Ross
 Vice-President U.S. Operations
- Robert D. Weir
 Vice-President Canadian Operations
- Robert A. Wall
 Vice-President Finance
- Richard E. Cheetham
 Vice-President Land
- Lorraine Lawrence
 Corporate Secretary

SOLICITORS

Code Hunter
 100, 640 - 7th Avenue S.W.
 Calgary, Alberta
 T2P 3A6

AUDITORS

Peat, Marwick, Mitchell & Co.
 2500, 700 - 2nd Street S.W.
 Calgary, Alberta
 T2P 2W2

TRANSFER AGENTS

Royal Trust Corporation of Canada
 in Calgary, Toronto and Montreal

STOCK LISTING

Toronto Stock Exchange
 Alberta Stock Exchange
 Montreal Stock Exchange
 (Symbol — DPL)

PRINCIPAL BANKERS

Bank of Montreal
 Calgary, Alberta

United Bank of Denver
 Denver, Colorado

